Reflections of a Drafter: Fairfax Leary*

PROFESSOR LEARY: Well, I may take a part of your story away from you, Al Dunham, but there was once a great argument on the floor of the Law Institute between Soia Mentschikoff and a distinguished lawyer from Pittsburgh, John G. Buchanan.[1] John expressed at great length his regard for Soia Mentschikoff. He alluded to the fact that he was almost always on Soia's side, but he wanted everbody to know that he felt like his old professor, Professor Thayer[2] of the Harvard Law School, who had great reverence for John Marshall. Every case of John Marshall's in constitutional law was treated with great delicacy, except one at the end of the course where he tore into it. When he finished, he said, "Now, I have such reverence for Mr. Justice Marshall that you must know that if I disagree with him, I must be right." And on that the Institute voted for Buchanan's position against Soia.

In these presentations we're going to be like congressmen; we're going to be able to extend our remarks for the record. The Ohio State University Law Journal is here and is taping what we say. We're going to get a chance to edit it and a chance for the absent Grant Gilmore to make customary Gilmorian comments on everything we've said, and Soia will be able to comment on anything that was said in her absence.

I must disagree with some of the things that Soia said, but before doing that I want to point out I have great reverence for Dean Mentschikoff. There were a couple of points she made about the lack of special interest pressures and I just have to differ the least little bit. It's with some trepidation that I do this, having been described by Soia as one who was accepted for the Code's drafting staff, as an associate reporter for Article 3 and later as a reporter for Article 4, because I knew absolutely nothing about it. I do have to admit—confession is good for the soul—that the lowest grade on my law school transcript was that famous course of "Bills and Notes," as we then called it. But there was pressure, at least indirectly, to develop a Code that could be adopted. That meant one special interests would not block.

I shall just mention a few instances in Article 9 to show you the kind of pressures that did influence the drafting. I was told to draft a certificate of title part for automobiles to go with Article 9.[3] I had done some empirical research in certificate of title work. I went to a little secondhand car lot. I couldn't find the owner there because it was dark. So I went way in the back and there he

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1. Mr. Buchanan was also a Vice President of the American Law Institute and was instrumental in obtaining the financing of the Code project by the Maurice and Laura Falk Foundation of Pittsburgh.

2. The reference is to Professor James Bradley Thayer, who taught evidence and constitutional law at Harvard Law School. Professor Thayer died in 1902. His participation may be apocryphal.

3. In the May 1949 Draft, Article 7 covered "Secured Transactions." There was a Part 8 captioned "Vehicle Liens," at 691–704, with a note stating it was a Reporter's draft, not as yet considered by the Chief Reporter and staff, advisers, or the council of the American Law Institute.

was with a tool putting treads in otherwise bare tires. I said, "This is my man. I'm going to do some empirical research." I said, "Here in Pennsylvania, if I came in here with a New York Cadillac, New York plates, wanted to sell it to you, would you buy it?"

He said, "Sure, I'd buy it the next day."

I said, "What do you mean?"

"Well," he said, "New York is one of them nontitle states, ain't it?"

I said, "Gee, how did you know that?" He said: "Counselor, you're certainly ignorant. The reason is I get a little book from Boise, Idaho, for 15 bucks a year that tells me exactly how the liens are put down on every automobile by every state, also tells me where to send the telegram to find out if you really own it. Just let me see your owner's card and the numbers and we could make a deal tomorrow."[4]

But the National Association of Motor Vehicle Commissioners said, "ALI-NCCUSA, what are you doing in our bailiwick? That's our statute. If you leave that part in there, then you're never going to get your Code through a single legislature, because we can oppose it and we know how."[5]

All along there were other indirect pressures on the draftsmen from special interests. These pressures were felt through various and sundry people who got the information from their contacts and passed it on. There was great pressure to produce an adoptable Code, and, therefore, certain interests who might oppose the Code had to be pacified.

One that comes to mind involved the railroad interests. So in the earlier drafts of the Code, you will notice in 9–104 there's a nice little exemption for car-trusts as railroad financing of cars.[6]

Another was the insurance industry and sure enough you'll find their exemption in 9–104.[7] Finally, there's no way you can have a Bank Collection Code and exempt banks. Hence that part of the Code had to be drafted so as not to produce united opposition.

One other little story I was told—this is, I suspect, apocryphal,—but I was told that Professor Llewellyn was presenting the names of the new group of draftsmen, of which I was one, to the Council of the Law Institute, at about the same time as the 1947 meeting of the Institute in Philadelphia. He first said he had persuaded Bill Prosser to work. Bill had agreed to do it for the rather small stipend that was coming out of the Maurice and Laura Falk Foundation, if nobody would question his expense accounts for eating when he came to

4. *See* Leary, *Horse and Buggy Lien Law and Migratory Automobiles*, 96 U. PA. L. REV. 455 (1948).

5. Later in 1955 the Motor Vehicle Commissioners and the National Conference of Commissioners on Uniform State Laws did collaborate in the drafting of a Uniform Motor Vehicle Certificate of Title and Anti-Theft Act. *See* SELECTED COMMERCIAL STATUTES 1139–55 (West 1981).

6. UCC § 9–104(e) (1966) provided that Article 9 does not apply to "an equipment trust covering railway rolling stock." It was removed in the 1972 Amendments.

7. UCC § 9–104(g), until amended in the 1972 version, provided that Article 9 did not apply "to a transfer of an interest in or a claim under any policy of insurance." In 1972 the following language was added: "except as provided with respect to proceeds (§ 9–306) and priorities in proceeds (§ 9–312)."

various and sundry meetings. Bill was a good deal of a gourmet. That was agreed.

Then Karl Llewellyn said William E. Britton had agreed to serve as a consultant if nobody would question his expense accounts for liquor when he came to the meetings. Again agreement.

"Then," said Mr. Llewellyn, "there is Fairfax Leary." And George Wharton Pepper, President of the American Law Institute said, "I don't think you better tell us what he specified."

I was told when I started to work on the project that the Code was going to be a tight Code, with very little room for agreement otherwise. Being a good soldier, I started out to try to draft a bank collection statute that would not be open much to agreement otherwise. Well, what I felt reading through the bank collection material in the literature, was the need to know how the banks in fact operated. The first thing I did was to go down to a large bank in Philadelphia that did a lot of check collection work, and I said, "I'd like you to attach me to a check and let me just go through the way you process it to see what banks in fact do."

They said, "That will not be possible because the check has to go through a number of very small slots. You won't quite fit, but we'll let you see it go in and we'll show you where it comes out."[8]

I also wanted some information about the volume of checks being processed, because there was one discovery, which I think was made somewhat about that time, although it may have been noted before, and that was the fact that no bank collects *a* check; they collect great wads of them at one time. Nobody seemed to know much about how many items any particular bank handled in a day, so I wrote a number of banks and I received some interesting letters.

One answer said: "We know, Professor Leary, that you're engaged in an important undertaking. We've never counted our checks before, so this morning we weighed the incoming clearings on a scale. Then we kept putting checks on the scale until we got to one pound and in that way we were able to find out that we were processing about half a million checks that morning."

Another one did it a little differently. They said, "We measured the yards of adding machine tape that were necessary to proof our incoming collections and multiplied by the number of items to the yard, to give us a total, and we have so many."

And then Tom Paton, Jr., General Counsel, of the American Bankers Association, sent out an American Bankers Association questionnaire to a lot of small banks who had assets in those days of less than 5 million, and we found out what their volume was.

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8. The reference was to the revolving drum hand activated sorters then in use. The drum had 24 pockets. The operator hand fed checks into a slot and typed the amount. The check was endorsed and a recordak picture was taken while the check passed through the slot into the selected pocket. The machine prepared 25 adding machine tapes, one for each pocket in the drum, and a total tape for proof purposes.

Well, that was important because, as I found out from that study, banks really have two collection channels. If, then, we're going to follow the rule of the drafters that what the people in fact do is how we should draft the statute, then we ought to have provisions in the statute for two channels. But the Code does not clearly provide for the non-cash item.

Anyway, when I came on board, I attempted to get a draft providing specifically for a double channel of collections, and with very limited room for contracting out of the Code rules. You will find in section 1–107 of the 1950 draft that nothing was to be subject to agreement otherwise unless the statutory sections said so.[9] But even by that time many sections provided for agreement otherwise, especially in the bank collection area.

Then we came up against a Committee of Counsel to the Federal Reserve Banks. The Committee was headed by O. J. Schlaikjer, Esquire, of Boston,[10] and consisted of a number of other counsel for Federal Reserve Banks. I remember a number of meetings up in the cold of Boston in which, unkindest cut of all, one of them asked me how old I was, and then he said, "Well, you're just a kid; we're not paying attention to you."

We proceeded with some more drafting, but it was the Committee of Counsel to the Federal Reserve Banks that said we should not have two-channel collection, notwithstanding that they had Reg. J, at that time for the cash-item channel and Reg. G, for the noncash item. I think they felt that if control stayed with them as regulators, they could control variations. On that, they may have been right. The two channels of collection still exist separately in the present regulation J.[11]

Well, the next thing we tried to do was to find a cutoff point for priorities, and for the time when a bank changes from being a payor bank, in the check system, to being a bank that has something to remit or has made some payment. First I was told the thing to do was to make that a very early cutoff point. Well, I talked to the people who were handling checks for a couple of the larger banks, and they all told me, "Sure, we can tell you approximately, that is within a very few minutes of when the check came into our organization." Millard Ruud[12] last night asked me why we didn't have a cutoff point fixed at the time the item hit the bank. The item would then take priority over subsequent attachments, garnishments, *et cetera,* and probably even notices of bankruptcy.[13] All it says in the federal Bankruptcy Act is that the trustee

9. The provision read "When Rules of this Act Mandatory and Not Subject to Modification by Agreement. The rules enunciated in this Act which are not qualified by words 'unless otherwise agreed' or similar language are mandatory and may not be waived or modified by agreement."

However, by May 1950 § 4–103 of the Bank Collections Article had a pre-amble reading "Notwithstanding section 1–107 the rights and obligations provided in this Article may be waived or modified by agreement. . . ."

10. Mr. Schlaikjer was then Vice President and Counsel to the Federal Reserve Bank of Boston.

11. 12 C.F.R. § 210 (1981).

12. This reference is to Professor Ruud of the University of Texas Law School, formerly Executive Director of the Association of American Law Schools.

13. When legal process against an account was served on a bank, the time of receipt was recorded thereon. Checks were not so stamped. This procedure applies today. Still checks carried a "batch number" and the

gets the property of the debtor. If we had not already made that portion of the account the property of the debtor, we'd probably be all right in bankruptcy. Bankers didn't want the early cut offs because they wanted to be able to take set offs at the very last minute. They also thought it would help depositors issue stop orders at a later time.

Well, *that* was knocked out by the Committee of Counsel of the Federal Reserve and by a number of bank lawyers who said there was no way anybody could tell accurately, for priority purposes, when an item was received, depending on, you know, how accurate you have to be.

We then tried to work a day blockage. That is, in posting checks, the bank had to post checks that came in on Monday before it posted checks that came in on Tuesday, because as you all know, right after the war the deferred posting and delayed returns rule came out. Under that rule, instead of having to pay finally or dishonor the check before close of business on the day in which it was presented, banks were given until midnight of the day after, if a provisional payment was made on the day of receipt. The reason for this was because the volume was such that no bank could process them in the normal clearing house deadline, receiving them at 10:00 and then have to return "not good" items at a 2:00 or a 3:00 p.m. return item clearing. Banks just couldn't do it. Susie, who worked in the collection department, couldn't go out to lunch with anybody, she had to work straight through, so the turnover was simply awful. Thus errors were increasing mightily.

Well, the bank lawyers didn't like the day blockage, so we invented something called the midnight deadline. And up until and through the spring 1950 draft that was the basic cutoff point for priorities and for when the check was finally paid. So we had to eliminate all earlier cutoffs. We were told that Federal Deposit Insurance was such a new thing that it was not right to have a statute depending on Federal Deposit Insurance, and the Committee of Counsel of the Federal Reserve Banks also said they didn't think anything should be founded on the way banks did things now because they might do them differently somewhat later. Hence the only distinction, perhaps, between cash items and non-cash items is that stated in section 4–302(a) and (b).[14]

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operating people knew the time the number was assigned for use. In view of the "Trickle Down" theory of the effect of the receipt of a notice in UCC § 1–201(27), the key time—when the legal process reached those performing the transaction—equally could only be closely approximated. The cut-off finally adopted by UCC § 4–303—the completion of the process of posting—is today not susceptible to precise timing for priority purposes.

14. UCC § 4–302 divides all items into two classes:

1. Demand items other than documentary drafts; and
2. Other items.

The penalty of "accountability" for a failure to observe the midnight deadline applies to clean "demand items" "whether properly payable or not," but only applies to "other items" if they are "properly payable." The term "properly payable" is defined in UCC § 4–104(i) to include "availability of funds" at the crucial time. The Fifth Circuit Court of Appeals is not correct in using the right to create an overdraft under § 4–401(1) as making all items properly payable as that court ruled in Union Bank of Benton v. First Nat'l Bank of Mt. Pleasant, 621 F.2d 790 (5th Cir. 1980) (first of series paid, balance "properly payable" despite lack of funds when presented).

How have Article 4 and Article 3 fared with some current issues? I am not going to complete the discussion of one issue without a reference to White and Summers, so I'll do it now. There is on page 702 of the White and Summers book on the Uniform Commercial Code, a sentence which I can clearly remember, because it is directed at me. It reads, "We see no great virtue in Professor Leary's position."[15] A footnote states that there is, however, some support for these in the report of the New York Law Revision Commission.[16] The issue we split on here is whether 4–303 gives a holder any rights against the drawee (the book argues it does) or whether the basic rule that a drawee is not liable on the instrument until the drawee signed it[17] or the bank has created proceeds by paying the item or is made liable by statute, which is my position and explains the *West Side Bank* case.[18]

Jim White also takes the position—I told him I was going to say this today—that if a payor bank makes a payment by mistake, it may not recover that payment because there is nothing in 4–213 which permits any recovery for a mistake in payment,[19] and Article 4 controls Article 3[20] where they are inconsistent. I take the opposite position. Article 4 covers the *time when* final payment occurs and Article 3 covers *the effect of* final payment and there is no inconsistency.

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15. J. WHITE & R. SUMMERS, THE UNIFORM COMMERCIAL CODE 702 (2d ed. 1980).

16. *Id.* at 702 n.163.

17. UCC § 3–401(1) "No person is liable on an instrument unless his signature appears thereon" and again in UCC Section 3–409(1) ". . . and the drawee is not liable on the instrument (check or draft) until he accepts it." Acceptance is defined as "the drawee's signed engagement to honor the draft." § 3–410(1). The only section imposing drawee liability "off the item" is UCC § 4–213(1) imposing accountability "for the amount of the item" upon a final payment. The section does not say expressly to whom the accountability runs, but oviously the owner of the paid item is meant. Accountability is also imposed for missing the midnight deadline by § 4–302. Professors White and Summers feel that § 4–303 gives a holder some right if the bank honors a stop payment order it is not obliged to honor. The contrary argument is that the Section controls the rights between the bank and the initiator of the relevant notice, order or process, and that had § 4–303 been intended to create "off the item" liability to the presenter of an item the "accountability" language would have been used, instead of language to "terminate, suspend or modify the bank's right or duty to pay the item." The Code carefully refrains from imposing such a duty on anyone but the drawer-customer of the item.

18. West Side Bank v. Marine Nat'l Exchange Bank, 37 Wisc. 2d 661, 155 N.W.2d 587 (1968). First, it is important to note that the case was an appeal from an order denying a motion by plaintiff depository bank, holder, against a payor bank. The issue was whether the payor bank had completed its "process of posting." The strict holding was, therefore, that the payor bank's affidavits raised a triable issue of fact as to whether it had completed *its* process of posting. The issue was argued on the theory that the payor bank's claim that the time for exercising judgmental review in *its* process of posting had not expired, and did not expire if there was time to reverse the entries made and return the item to the Milwaukee Clearinghouse under its rules. West Side argued the case on the theory that UCC § 4–109(e) only permitted the reversal of erroneous entries and erroneous actions, not actions or entries correct when taken but no longer desired to stand because information subsequently received made the reversal desirable. The ruling was that, as worded, § 4-109(e) did not preclude a process of posting that permitted the judgmental review to continue until just before the expiration of the deadline for returns. Interestingly the entire argument and the court's opinion was directed to a determination as to whether the payor bank had become accountable under § 4–213, not § 4–303. The plaintiff was a holder suing a payor bank.

The decision seems correct in view of the preamble to § 4–109 where the process of posting is what is, in fact, the procedure in the payor bank "including one or more of the following *or other* steps *as determined by the bank*. . . ." (emphasis added). Hence even if the court had adopted the interpretation that § 4–109(e) referred only to erroneous entries, the preamble would permit a payor bank to adopt one *other* step involving the reversal of correct entries on the basis of information received when the entry was made.

19. UCC § 4-102; J. WHITE & R. SUMMERS, THE UNIFORM COMMERCIAL CODE 619 (2d ed. 1980).

20. UCC § 4–102; J. WHITE & R. SUMMERS, THE UNIFORM COMMERCIAL CODE 600 n.47 (2d ed. 1980).

Fortunately, I have very strong dicta in my support from a case called *Demos v. Lyons*[21] in New Jersey—and I see a New Jersey lawyer nodding,[22] so I guess I pronounced it correctly. It's an unfortunate case in a way—it outlines exactly the way a bank can recover money paid under mistake of fact, even though the payment was a final bank payment, stating that 4–213 covers time when the final payment is made. Then the court said you go to 3–418 for the effect of a final payment. In great excitement I called up counsel and congratulated him.

He said, "What do you mean? I lost the war. The court went on to say there hadn't been any mistake made in this case. So, therefore, we couldn't recover, so all we've got is probably a strong dictum."

There was a prior case that reached the right result but didn't spell it out; that was the *Maplewood*[23] case.

What are some other problems that have come along? Well, there's an absence of any clear provision in Article 4 taking care of a practice that seems to be growing up, and the cases are appearing in the books, on the effect of a second presentment of a previously dishonored and returned item.[24] What happens when the item comes back is that the operating department says, "Well, look, let's keep calling this drawer; maybe he (or she) will come and put some money in the account and then we can pay this." They completely forget about the midnight deadline, it happily passes on the second presentment—and the cases are about five to three. The five say, "Well, at the end of the midnight deadline after the second presentment, you're liable. Because you have paid it you are responsible." The payor bank is, in the Code language that they put in the Massachusetts revision and officially thereafter, "accountable for the amount of the item," according to the majority. But the majority is wrong.[25]

This is another point that I argue with Jim White. I say "accountable" means you have to make an accounting, and I've never heard of an accounting situation where all counterclaims and defenses didn't come in. So I don't find anything in the word "accountable" that prevents defenses. As to a represented item, there is much in the Code that treats a dishonored item differently from the same item before dishonor. Section 4–301 implies that a

21. 151 N. J. Super. 489, 376 A.2d 1352 (1977).

22. The reference is to Donald Rapson, Esq., also teaching at Columbia Law School in recent months. Mr. Rapson knows a great deal about the Code.

23. Maplewood Bank & Trust Co. v. F.I.B., Inc., 142 N.J. Super. 480, 362 A.2d 44 (App. Div. 1976). The interplay of UCC § 4–213(1) and § 3–418 was not argued in the case. Recovery for payment under a mistake of fact was allowed.

24. *See, e.g.*, First Nat'l Bank of Md. v. Columbia Auto Sales, Inc., 31 U.C.C. Rep. Serv. 1049 (Md. Dist. Ct. Howard County, 1981).

25. The problem is discussed in detail in Leary, *Some Bad News and Some Good News from Articles Three and four*, 43 OHIO ST. L.J. 611 (1982). The concentration of discussion on UCC § 3–511(4) in the cases is unwarranted.

notice of dishonor need not be given again if it had already been sent.[26] Also there can be no holder in due course if the holder has reason to know that he is taking a demand instrument after demand has been made.[27] Hence for Section 4–302 purposes a re-presented item should be treated as an "other item" not as a demand item.

The interrelation of 3–419(3), 4–302, and 3–419(1) on conversion, is perhaps not as clear as it might be and ought to be cleared up. Jim White says "what [the courts] have done to [section 3–419(3)] shouldn't happen to a dog."[28] I think maybe what they've done is not quite that bad, but there is a division of authority that's developed on the issues raised by that subsection.[29] Much of what the courts have specified as constituting reasonable commercial standards just cannot be implemented in actual practice because of the excessive costs that would be incurred.[30]

Has there been any failure to provide for new technologies and new banking practices in the Code? Here I'm going to just take a little time to point out that in the 1949 draft I had a provision allowing electronic presentment of an item.[31] I was told that Buck Rogers really didn't live on the earth, and that there was no reason that should be in the Code; take it out. Yet, the technology was there even though the MICR line was not yet in use.[32] Western Union had already marketed facsimile transmission of items and today we have several subsequent developments, as well as the use of the MICR line and the ACH transmission thereof in check truncation. It would have been nice, I think, to have had something like that in there so that we could develop what they now do in New Zealand, which is a form of check truncation. In New Zealand, banks transmit the MICR line on the bottom of the check and the check comes later.[33] I assume that all law teachers here, know what a

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26. Section 4–301(3) reads "Unless previous notice of dishonor has been sent," and it does not say how long ago, "an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section." Also the cases disregard UCC § 3–501(4), as amended in 1966, reading "Notwithstanding any provision of this section, neither presentment nor notice of dishonor nor protest is necessary to charge an indorser who has indorsed an instrument after maturity."

27. UCC § 3–304(3) provides "The purchaser has notice that an instrument is overdue if he has reason to know . . . (c) that he is taking a demand instrument after demand has been made. . . ."

28. Summers says so too. J. WHITE & R. SUMMERS, THE UNIFORM COMMERCIAL CODE 591 (2d ed. 1980).

29. This too is discussed in detail in Leary, *Some Bad News and Some Good News from Articles Three and Four*, 43 OHIO ST. L.J. 611 (1982).

30. For example, in Tormo v. Yormack, 399 F. Supp. 1159 (D.N.J. 1975), knowledge that the depositor was under indictment for obtaining money by fraud should have induced management to verify payees' endorsements on all deposited checks.

31. The reference is to the May 1949 draft. Section 3–617(3) on Methods of Forwarding and Presenting reads "If the original item follows within a reasonable time a collecting bank may make presentment to the payor bank in any substitute manner agreed between them, as by facsimile or other adequate demand."

Comment 6 stated "Subsection (3) permits the use, by agreement, of an equally expeditious means of collection including electric facsimile transmission."

32. Western Union was then marketing an electric facsimile transmission service called, as I remember "FAX." We now also have Quip and Quix as well as an ACH network capable of transmitting the MICR line.

33. See the report of Stanley Goldstein to the Canadian Department of Justice, "Changing Times: Banking in the Electronic Age," 43–44 (1979) discussing the New Zealand procedure, and the check truncation practices in Sweden and Belgium. The report has been made available by the Interdepartmental Steering Committee on the Electronic Payments System of the Government of the Dominion of Canada so that interested parties may express their views.

MICR line is. It's those funny little figures at the bottom of the check that are in magnetic ink so a computer can read them. And that's all that will be transmitted in check truncation in the U.S. At a later date, if anybody wants the check, as the result of examining the statement, it can be obtained if requested in, say, ninety days. After that time only a photocopy will be available.

But electronic transmission of the MICR line is, fortunately, in view of the way Prosser drafted Article 3, a good presentment. A bank takes very little chance in doing it, because, as Bill Prosser used to say, presentment is any demand for payment anywhere.[34] Right in this hotel, if I find the maker of a note in the men's washroom, I can ask him if he wants to pay this note. If he says you know what you can do with that piece of paper here, that would be a dishonor. The presenter could then send the notices necessary to charge secondary parties.

How are we doing on what is a "bank?" Well, that's one where we, I think, completely muffed it. The definition of a bank is the most circular definition I've ever run across.[35] It says a bank is a person engaged in the business of banking. Now, that helps a lot. Just to show you how up to date we old Code drafters try to keep, let me quote from tomorrow's New York Times, where it says, "Nervous banks start striking back"[36] because the issue is, is Merrill Lynch a "bank?" You can certainly get drafting privileges against your securities account at Merrill Lynch, and what about all these other money market funds that are tied up with drafting privileges?

Well, I suggest again, if you have the faith in the reasonableness of the courts that Karl Llewellyn had, you would have a very good chance of persuading a court in today's world that any institutional entity that permits drafting on funds that it holds for, or owes to others, is, for the limited purposes of Articles 3 and 4, to be treated by analogy as if a bank. Then all of the law that currently applies to checks would apply to the new drafts.[37]

Bank credit cards present a new issue. We haven't anything on that in the Code. As to truncation we don't have much except that any demand is a good presentment. On the other hand, there will have to be an agreement with the bank on which the demand is made that they will not assert any of their rights,

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34. Ever since at least the May 1949 draft UCC § 3-504(1) has read "Presentment is a demand for acceptance or payment made upon the maker, acceptor, drawee or other payor by or on behalf of the holder." To show that any Code listing of ways of making a presentment is not exclusive, the next subsection starts "Presentment may be made . . ."

35. UCC § 1-201(4) reads "'Bank' means any person engaged in the business of banking." Canada has already modified the definition in its Bills of Exchange Act to include thrifts known there as "near banks," by adding a section 164.1 reading "In this Part, 'bank' includes every member of the Canadian Payments Association established under the *Canadian Payments Association Act* and every credit union as defined in that Act, that is a member of a central, as defined in that Act, that is a member of the Canadian Payments Association." The recommendation of the Law Reform Commission of Canada in its Report No. 11, "The Cheque—Some Modernization" to redefine a check as a draft drawn on a deposit institution and then define the latter term to include all "organizations, including instrumentalities of the Crown, that accept deposits and have the right to apply for membership in the Canadian Payments Association."

36. New York Times, Jan. 10, 1982, at 55, col. 1.

37. The point is more fully developed in Leary, *Is the UCC Prepared for the Thrifts' NOW, NINOW, and Share Drafts?* 30 CATH. U.L. REV. 159 (1981).

such as physical presentment of the instrument, a chance to examine it, *et cetera, et cetera,*[38] which means that that little old guy with the green eye shade, who supposedly is looking at every signature on a check, isn't going to be able to do it in the brave new world of check truncation. I can tell you that they don't examine for signatures now, in the case of checks for smaller amounts. I've several times gotten checks back with no signatures.

I think another point to be made is a failure in the drafting of Article 3 to foresee the coming of inflation and the strong impact it would be having on such things as variable rate notes of one kind or another. The drafting of the Code, as to formal requisites, is rather fixed. To meet the sum certain requirement, the note has to be with a *stated* rateof interest,[39] and the comment says, you have to be able to make the calculation from the face of the instrument.[40] Now, that comment's a lie, because all you have to do is read in section 3–118 where it says, if you just say with interest and don't name any rate, you're perfectly negotiable.[41] And the rate in such a case is the judgment rate at the place of payment.

How are you going to calculate what's due on a note issued in New Jersey, payable in Japan? How many here know the judgment rate in Japan at the moment, or India, or any of these other places with which we're now dealing?

Another defect in Article 3 was a failure to consider the stages of the payment process at which wrongful intrusions occur. We did a pretty good job on the drawer's issuance of a check and wrongful intrusion by the drawer's employees. There is section 3–405;[42] you've got Embezzling Ernie, the check signer; you've got Payroll Padding Pete, the "name-supplier"; "Invoice Inserting Ike", and they're all taken care of as to those scams. The endorsement is made effective. But going along with making them effective, there is a judicial gloss that goes beyond the wording of the Code. They attempt to look at the fault of the taker of the check with the effective endorsement.

We have a couple of situations that seem to be hardening into rules of substantive law. If a check is payable to a corporation but endorsed to somebody else by the corporation, these cases say that is a check given in a

38. UCC § 3–505 sets forth these rights. Because requiring the evidences and exhibitions is only permissive, a payor bank can agree not to assert its right to obtain them.

39. UCC § 3–106(1)(a), (b) and (c) all use "stated."

40. The reference is to the last sentence of comment I which also adds "and this section does not make negotiable a note payable 'with interest at the current rate.' " Query the negotiability of a variable rate note!!

41. UCC § 3–118 provides that its rules apply to every instrument (a term defined as negotiable instrument) Rule (d) provides "Unless otherwise specified a provision for interest means interest at the judgment rate at the place of payment from the date of the instrument, or if it is undated from the date of issue."

42. UCC § 3–405(1) makes three types of endorsements "efective": the impostor, the authorized signer who intends the payee to have no interest, and the agent or employee of the maker or drawer who supplies names of payees with the intent that they should have no interest. This is to be contrasted with the negligence section, UCC § 3–406, which uses a "precluding" approach in favor of a holder in due course or drawee or other payor acting in "good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business."

transaction so irregular on its face as to call into question the ownership of the item. *Brighton, Inc., v. Colonial First National Bank v. Avenel*[43] in New Jersey is one of those decisions. There are others all around.[44]

Another rule involves items payable to a bank presented by a customer for deposit to the customer's account, even though the endorsement is effective because the issuance of the check originated from a name-supplying employee. We have several cases that say, in the case of check payable to a bank, that the bank is liable for doing anything with that check without calling up the drawer, except putting it in the drawer's account or paying the drawer's debt.[45]

We even have a lovely case in New York where the endorsement was effective. The crook—and I don't think any other crook will do this again now that the case has come down—exactly copies customer's endorsements, including the little words "for deposit," so the New York Court of Appeals said, "Well, somebody's got to be able to sue the depositary bank, so we're going to give the drawer standing to do it," because the person who made the endorsement used a restrictive endorsement.[46] But under section 3–405(1)(c) such an endorsement is allegedly effective against the drawer, and, therefore, you'd think only the crook would be able to quarrel about the further endorsement. Oh, no, says the New York Court of Appeals. The drawer recovers in conversion.

Now, there is a committee working to take care of bringing Articles 3 and 4 up to date. It is called the 3-4-8 Committee. They have a draft which has all kinds of stuff on the front of it about how we can't talk about it, quote from it, refer to it. They said I could mention the existence of it. Now, I think that Articles 3 and 4 are areas where we ought to apply that old saying "For whom the bell tolls." We can hope that the committee is taking the drafting of the new Payments Code the way Soia and others of us have thought of Articles 3 and 4, that is, not as a code for lawyers, not as a code for Peter Coogan, but a code primarily for practical operating men doing practical work. Therefore, it seems to me, the organization and structure should definitely be keyed to the

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43. 176 N.J. Super. 101, 422 A.2d 433 (Super. Ct. App. Div. 1980), *aff'd per cur.*, 86 N.J. 259, 430 A.2d 902 (1981). On its facts the case may stand for no more than that "horrendous commercial dereliction" like the general obligation of "good faith" is an overriding principle preventing the egregious wrongdoer from sheltering under a literal reading of the Code.

44. *See, e.g.*, Empire Moving and Warehouse Corp. v. Hyde Park Bank & Trust Co., 43 Ill. App. 3d 991, 357 N.E.2d 1196 (1976); Sherriff-Goslin Co. v. Cawood, 91 Mich. App. 204, 283 N.W.2d 691 (1979); Bd. of Higher Educ. of the City of N.Y. v. Bankers Trust Co., 86 Misc. 2d 560, 383 N.Y.S.2d 508 (N.Y. Co. Pt. 4, 1976). In *Empire Moving and Warhouse Corp.* the court found support for its rule in a publication of the Bank Administration Institute stating *inter alia* that "checks payable to a corporation should not be cashed or accepted for deposit in the account of an individual but should be deposited in the corporation's own account unless a corporate resolution authorizes otherwise." 43 Ill. App. 3d at 994, 357 N.E.2d at 1198.

45. *See, e.g.*, Sun 'N Sand, Inc. v. United Cal. Bank, 21 Cal. 3d 671, 148 Cal. Reptr. 329, 582 P.2d 920 (1978); Bank of Southern Md. v. Robertson's Crab House, Inc., 39 Md. App. 707, 389 A.2d 388 (1978). This line of cases stems from Sims v. United States Trust Co. of N.Y., 103 N.Y. 472, 9 N.E. 605 (1886). The cases are discussed in Whaley, *Negligence and Negotiable Instruments*, 53 N.C.L. REV. 1, 15–17 (1974).

46. Underpinning and Foundation Constructors, Inc. v. Chase Manhattan Bank, N.A., 46 N.Y.2d 459, 386 N.E.2d 1319, 414 N.Y.S.2d 298 (1979).

stages of the processing of an item through its life span. Draftsmen should state together the rules applicable to each stage. I hope the committee will not structure the draft on some sort of theoretical functional basis such as putting together all record keeping provisions, this kind of provision, that kind of provision, and so on. But we'll have to wait and see how the committee does come out.

Aside from that, I tend to agree with Peter that it's remarkable how well the whole Code has worked considering that it was prepared, apparently by those starting in complete ignorance, as you've been told that those selected as draftsmen were only those who were ignorant of the subject to be codified.

I think there was an unconscious feeling that it was necessary to get an adoptable act, and many, but fortunately not too many decisions were made wherein truth, justice, and beauty had to give way to that practicality for which the bell tolls.

Thank you.